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FEDERAL COMMUNICATIONS COMMISSION
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February 16, 2001

VIA HAND DELIVERY

Dorothy Attwood, Esq.
Chief, Common Carrier Bureau
Federal Communications Commission
Room 5-C450
445 12th St., SW
Washington, DC 20554

Re: February 1, 2001 ex parte in CC Docket No. 99-68

Dear Ms. Attwood:

On February 1, 2001, the major incumbent local exchange carriers ("ILECs") filed their latest installment in a series of ex parte filings purporting to show the impact of the Common Carrier Bureau's proposal on local exchange carrier reciprocal compensation obligations. In this ex parte, the ILECs attempt to support a key underlying assumption made in their December 22, 2000 ex parte filing, namely, that there will be substantial continued growth in dial-up minutes resulting in a continued increase in ILEC reciprocal compensation obligations. In fact, the ILEC assertions do nothing to undermine the result demonstrated in our prior ex partes, namely, a substantial decrease in ILEC reciprocal compensation obligations. This latest ILEC ex parte filing, however, is most significant for what it does not say and the concessions it contains.

In the February 1 ex parte filing, the ILECs rely on an analyst report from Morgan Stanley Dean Witter ("Morgan Stanley") that indicates that, contrary to the constant $0.004 per minute rate for reciprocal compensation used in the ILECs' December 22 calculation, market forces have already reduced and are expected to further reduce ILEC reciprocal compensation obligations without any action by the Commission. The Morgan Stanley analyst report states, "We believe that per-minute charges will continue to fall at greater than 20%, from $0.002 to $0.0015 per minute." (Report at p. 14). As the Commission can see from Exhibit 10 of the analyst report, Morgan Stanley Dean Witter predicts the average rate will decline from $.002 in 2000,

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to \$.0015 in 2001, to \$.0012 in 2002, and to \$.001 in 2003.[1] Faced with this data, the ILECs are forced to acknowledge "that reciprocal compensation rates have declined significantly in some areas in the last year or so."

A second key estimate from their most recent filing is also highly suspect. In it, the ILECs interpret one chart from Morgan Stanley's analyst report to conclude that the number of dial-up Internet access users will grow by a total of 40% over the next three years. (p. 2). This estimate is highly suspect because it was predicated on at least one assumption that has already been proven to be wrong. Morgan Stanley supported this estimate of growth in part on "the emergence of free ISPs." (Report at 13) Just as quickly as they seemed to emerge, however, free ISPs have floundered.[2] The Morgan Stanley estimate of growth must be discounted to reflect the subsequent collapse of the free ISPs.

A second assumption in the Morgan Stanley estimate of growth of dial-up users is that customers will have only limited access to broadband. (Report at 13) The FCC's statistics tell a different story. According to the Commission's recent report on access to high-speed services, as of June 2000, residents of all 50 states and the District of Columbia and Puerto Rico have access to high-speed services, including subscribers in about 70% of all zip codes in the United States. According to the Commission, "High-speed subscribers are reported to be present in 96% of the most densely populated zip codes and in 40% of zip codes with the lowest population densities. The number of sparsely populated zip codes with high-speed subscribers increased by 69% during the first half of the year, compared to an increase of 4% for the most densely populated zip codes."[3] Further, the number of high-speed lines increased 57% in the first six months of 2000 alone.[4] Clearly, consumers demand dedicated bandwidth. Unless CLECs, ISPs, and even ILECs respond to that demand, consumers will move to other providers that offer broadband, such as fixed wireless, satellite or cable Internet service. Despite the ILEC rhetoric, the facts demonstrate that the growth of dial-up minutes will be constrained by the rapid and measurable deployment of advanced services.

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[1] Not only are these rates much lower than the ILEC rates used to calculate the impact of the Bureau's proposal, they are lower than the CLEC rates used to calculate the impact of the Bureau's proposal contained in Focal Communications Corporation's ("Focal") January 8, 2001 response to the ILEC December 22, 2000 ex parte filing. Focal used rates of \$.00275 in 2001, and \$.0015 for 2002 and 2003. As the Commission can imagine, using the Morgan Stanley estimates would significantly increase Focal's estimate that reciprocal compensation payments would decrease by 94% under the Bureau's proposal, and by 85% under the ALTS proposal.

[2] *See* "Bye-bye, Free ISPs," Rex Crum, *Upside Today*, Jan. 3, 2001, http://www.upside.com/Rex_Crum/3a52696eb_yahoo.html; "Free ISP Market in Turmoil," Rex Crum, *Upside Today*, Dec. 7, 2000, http://www.upside.com/texis/mvm/story?id=3a2edb941 (chronicling collapse of free ISP providers); *see also* "NetZero Q2 loss widens, warns about Q3 revs," Feb. 7, 2001, http://biz.yahoo.com/rf/010207/n07293253_4.html (discussing difficulties of free ISP NetZero).

[3] *Federal Communications Commission Releases Data on High-Speed Services for Internet Access*, Press Release, Oct. 31, 2000.

[4] *Id.*

Moreover, it seems the ILECs would have the Commission ignore the fact that, as the providers to the vast majority of subscribers in the United States, they are chiefly responsible for any lack of access to broadband services, requiring some customers to use dial-up to access the Internet. The ILECs grumble about growth in dial-up minutes, but live in denial that in large part they control whether Internet users have access to services that redirect their Internet usage off the switched local network. The sooner the ILECs make broadband accessible, or make access to the local loop less of an ordeal for other providers, the sooner their own reciprocal compensation obligations go down. Further, nothing prevents ILECs from actually competing for ISPs as customers so that dial-up minutes terminated to ISPs terminate on ILEC networks rather than CLEC networks.

While the ILECs' latest filing undermines their own December 22, 2000 ex parte filing, they have simply not addressed the extensive factual showing of the CLECs. The February 1, 2001 ex parte makes no mention of either the Merrill Lynch study on growth of dial-up Internet access minutes cited in the November 28, 2000 AT&T ex parte letter and the Focal ex parte letter, or the PriceWaterhouse Coopers study that shows a decline in dial-up Internet access minutes. The Merrill Lynch study cited by AT&T and Focal estimates dial-up Internet access minutes per on-line household to grow by only 7% annually. The PriceWaterhouse Coopers study stated that Internet usage per user in the United States declined by over 20% from 1999 to 2000 because of "the medium's maturity."[5] The most recent ILEC ex parte fails to address either of these studies.

Having one approach foreclosed by the facts, the ILECs, to support their proposal to gut reciprocal compensation arrangements, now attack existing Commission rules that require reciprocal compensation rates to be based on ILEC costs. The February 1, 2001 ex parte filing relies heavily on the estimated costs associated with soft-switches deployed by some carriers. (p. 2-3). Even if CLEC-specific costs were relevant, which under Commission rules they are not, this reliance is misplaced. While some carriers may have deployed soft-switches, most have not. Nowhere in the Morgan Stanley analyst report on Pac-West Telecomm does the analyst claim that Pac-West Telecomm has deployed any soft-switches. In fact, Pac-West Telecomm has no soft-switches in its network. For those carriers that have deployed no soft-switches, the analysis in Exhibit 10 of the Morgan Stanley Dean Witter report would clearly be wrong. For those carriers that have deployed some soft-switches, the number of conventional Class 5 circuit switches is likely to represent a much greater portion of deployed facilities in the network. If any estimate of CLEC profit margins based on CLEC switch costs using soft-switches were appropriate, it must also include a significant number of conventional switches. The Morgan Stanley analysis does not appear to do this.

[5] Wall Street Journal, December 28, 2000, citing November 1, 2000 PriceWaterhouse Coopers release. The release was appended as Attachment A to the January 9, 2001 Focal ex parte filing.

Finally, if it is true that technological advances such as soft-switches lower a carrier's costs, the ILECs should have every incentive to deploy them. Once deployed, an ILEC may submit cost studies to demonstrate exactly what the savings are, and what reciprocal compensation rate should be paid to carriers for networks that utilize such technological advances. If there is an impact from the eventual implementation of soft-switches by ILECs, the state commissions are well positioned to take these cost savings into account in their ongoing cost dockets.

It is clear that the ILECs' February 1, 2001 ex parte filing includes a number of facts that undermine the ILECs' previous statements to this Commission on the need for, and the impact of, their proposed transition to bill-and-keep. At the same time, these facts also support the CLEC claims regarding the impact of the Bureau's proposed reciprocal compensation regime.

Please let us know if we can provide you with any other information on this important topic.

Sincerely,

John D. Windhausen/mnf

John D. Windhausen, Jr.
President, ALTS

H. Russell Frisby/mnf

H. Russell Frisby, Jr.
President, Comptel

cc: G. Reynolds
J. Jackson
T. Preiss
R. McDonald
K. Dixon
M. MacBride
J. Goldstein
R. Beynon
D. Shetler
J. Zinman

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